STATE OF MICHIGAN

COURT OF APPEALS

TRADE PARTNERS, INC.,

Plaintiff-Appellant,

v

WILLIAM CHARTIER D/B/A FINANCIAL RESOURCE SERVICES, and TMS MORTGAGE, INC.,

Defendants-Appellees,

and

DAVID KITSMILLER, PENNY KITSMILLER, and DAVID K.JEWELERS, LTD.,

Defendants.

UNPUBLISHED
February 4, 2000

No. 211516
Kent Circuit Court
LC No. 96-004832-CK

TRADE PARTNERS, INC.,

Plaintiff-Appellant,

v

WILLIAM CHARTIER D/B/A FINANCIAL RESOURCE SERVICES, and TMS MORTGAGE, INC.,

Defendants-Appellees;

and

DAVID KITSMILLER, PENNY KITSMILLER, and DAVID K. JEWELERS, LTD.

No. 214410
Kent Circuit Court
LC No. 96-004832-CK

Defendants.

Before: McDonald, P.J., and Neff and Smolenski, JJ.

PER CURIAM.

In Docket No. 211516, plaintiff Trade Partners, Inc. appeals as of right from the trial court's judgment of no cause of action in plaintiff's complaint seeking judicial foreclosure of an interest in real property. In Docket No. 214410, this Court granted plaintiff leave to appeal the trial court's order awarding defendants' costs in the amount of $22,090.36 as sanctions under the offer of judgment rule, MCR 2.405(D). We reverse the trial court's judgment in Docket No. 211516, which renders plaintiff's appeal in Docket No. 214410 moot.

The trial court made the following findings of fact:

> In October 1993, defendant [David] Kitsmiller borrowed money from two investors, Donald Bender and Ed Kacos, to fund his store, David K. Jewelers. Kitsmiller and his partner, Thomas Smith, used the land contracts on their houses as security for the loans. The assignment of Kitsmiller's land contract to Mr. Kacos, which is the subject of this lawsuit, occurred in December 1993 but was not recorded until October, 1995. When Kitsmiller defaulted on the loan to Mr. Kacos in October 1995, Smith assigned a mortgage owned by his closely held corporation Capital Funding Network (CFN) to Mr. Kacos in satisfaction of the debt. In return, Mr. Kacos assigned CFN Kitsmiller's land contract, which was recorded in February, 1996. Soon thereafter, Smith ceased operating CFN and started a new company called Trade Partners (the plaintiff), to which the land contract was assigned.
>
> Meanwhile, Kitsmiller obtained a mortgage from defendant Financial Resources Services (FRS) which he used to pay off his land contract. Apparently, the title search failed to reveal that the land contract was encumbered by the lien, and Kitsmiller received a warranty deed to the property in December 1995. The mortgage was assigned the GE Mortgage Company, who in turn assigned it to the current defendant, TMS Mortgage, Inc. [TMS].
>
> Plaintiff asserts that its recorded lien on the land contract gives it priority over Kitsmiller as title holder and TMS, the mortgage holder. Defendants maintain that plaintiff's assigned interest is not a mortgage and therefore can have no effect on of [sic] the warranty deed obtained by Mr. Kitsmiller.

In its conclusions of law, the trial court found that

> The security interest in the land contract obtained by Mr. Kacos and assigned first to CFN and then to [plaintiff] was perfected before defendant Kitsmiller obtained legal title to the property. An equitable lien is thereby created on the property, and plaintiff is

> entitled to have the court enforce it against Kitsmiller without affecting his duty to repay the mortgage. Plaintiff has no cause of action against the mortgagors [sic] because they have no duty to protect plaintiff's interest.

The trial court subsequently entered a judgment of no cause of action against defendants FRS and TMS; declared that the interest of defendants FRS and TMS in the property is superior to any interest in the property claimed by plaintiff; and held that plaintiff was entitled to an equitable lien against the interest of the Kitsmillers[1] in the property in the amount of $206,796.86 which was junior and subject to the mortgage presently held by defendant TMS.[2] The trial court awarded defendants FRS and TMS costs against plaintiff as sanctions under MCR 2.405(D) and also awarded plaintiff costs against the Kitsmillers.

Docket No. 211516

Plaintiff contends that the trial court erred when it determined that plaintiff's duly recorded lien against a land contract vendee's interest in real property did not have priority over defendants' subsequently recorded mortgage against the same real property pursuant to Michigan's "race notice" statute, MCL 565.29; MSA 26.547. While we agree with plaintiff that the mortgage is subject to plaintiff's interest in the property, we disagree with plaintiff's characterization of its interest as a lien that has priority over the mortgage pursuant to MCL 565.29; MSA 26.547. In addition, while we agree with the trial court's determination that an equitable lien is appropriate here, we disagree with the trial court's determination of the amount and priority of that lien.

This case presents a question of law and therefore is subject to de novo review. *Michigan Basic Property Ins Ass'n v Ware*, 230 Mich App 44, 48; 583 NW2d 240 (1998). "Michigan law is quite clear that, when property is sold on a land contract, legal title is retained by the vendor and an equitable title or interest is obtained by the vendee." *Tidwell v Dasher*, 152 Mich App 379, 384-385; 393 NW2d 644 (1986). "By an assignment [of a vendee's interest in a land contract] the vendee conveys to the assignee his present interest in the lands, together with the right to obtain further interest and final title on the performance of the contract." *Gorman v Butzel*, 272 Mich 525, 530; 262 NW 302 (1935); *General Electric Co v Levine*, 50 Mich App 733, 736; 213 NW2d 811 (1973).

A vendee under a land contract receives only the equitable title to the property while the vendor retains the legal title. See *Ross Properties v Sheng*, 151 Mich App 729, 734; 391 NW2d 464 (1986). The vendee may assign or transfer this equitable interest. *Id.* When an assignment is made as security, "the vendee still retains an equitable interest in the contract, and on satisfaction of the obligation secured thereby, he is entitled to a reassignment thereof." *Krueger v Campbell*, 264 Mich 449, 452; 250 NW 285 (1933). However, if the vendee receives a conveyance from the vendor after an assignment of his interest, the vendee holds legal title to the property in trust for his assignee. *Levine, supra* at 737.

In its brief, plaintiff identified Michigan's "race notice" statute as MCL 565.29; MSA 26.547, which provides:

> Every conveyance of real estate within the state hereafter made, which shall not be recorded as provided in this chapter, shall be void as against any subsequent purchaser in good faith and for a valuable consideration, of the same real estate or any portion thereof, whose conveyance shall be first duly recorded.

While MCL 565.29; MSA 26.547 is part of Michigan's race notice recording scheme, we note that the scheme involves two aspects: constructive notice of prior recorded interests and the priority of those interests recorded first in time over unrecorded interests. In *First of America Bank v Alt*, 848 F Supp 1343, 1347 (DC Mich 1993), the federal court summarized the recording scheme:

> In Michigan, interests in real property are recorded with the register of deeds in the county where the property is located. All recorded liens, rights, and interests in property take priority over subsequent owners and encumbrancers. MCL 565.25; MSA 26.543. Where an individual fails to record a lien or interest in the property, that interest is void as against any subsequent interest holder who purchased the interest in good faith for valuable consideration. MCL 565.29; MSA 26.547. A person takes in "good faith" if he or she takes without notice of the prior unrecorded interest. . . . Thus, Michigan has adopted what is frequently known as a "race notice" statute: the first interest holder to record takes priority, unless that individual has notice of a prior unrecorded interest.

The court's analysis in *First of America* is consistent with the opinion expressed in *Edwards v McKernan*, 55 Mich 520, 526; 22 NW 20 (1885), in which our Supreme Court stated that "the effect of the recording laws was that the record of a conveyance, which is entitled to be recorded under such laws, operates as constructive notice to subsequent purchasers claiming under the same grantor." The Court in *Edwards* also stated that the predecessor to MCL 565.29; MSA 26.547 did not declare that the record shall be notice to subsequent purchasers, "but only that unrecorded conveyances shall be void as to subsequent purchasers in good faith whose conveyances shall be first recorded." *Id.* at 525-526. Consequently, we do not believe that MCL 565.29; MSA 26.547 applies here, because plaintiff does not possess a prior unrecorded lien in the property.

The trial court found that the Kitsmillers' assignment to Kacos (the "Kacos assignment") was intended to secure the note payable to Kacos (the "Kacos note"). The Kitsmillers, as vendees, assigned to Kacos their "present interest" in the property "together with the right to obtain further interest and final title on the performance of the contract." *Gorman, supra* at 530. This assignment of the Kitsmillers' vendee's interest as security for a debt owed by them became a "valid, separate and distinct interest in the property for security" which, upon recording, constituted constructive notice to subsequent purchasers of the assignee's claim against the property pursuant to MCL 565.25; MSA 26.543. *Boraks v Siegel*, 366 Mich 308, 311-312; 115 NW2d 126 (1962) (applying CL 1948 § 565.25, the predecessor of MCL 565.25; MSA 26.543). At the time of the transactions in this case, MCL 565.25; MSA 26.543 read in pertinent part:

> In the entry book of deeds, the register shall enter all deeds of conveyance absolute in their terms, and not intended as mortgages or securities, and all copies left as cautions, and in the entry book of mortgages he shall enter all mortgages and other

> deeds intended as securities, and all assignments of any such mortgages or securities; and in the entry book of levies he shall enter all levies, attachments, notices or lis pendens, sheriffs' certificates of sale, and United States marshals' certificates of sale, noting in such books, the day, hour and minute of the reception and other particulars, in the appropriate columns in the order in which such instruments are respectively received, and every such instrument shall be considered as recorded at the time so noted. And the record of such levies, attachments, notices, lis pendens, sheriffs' certificates, marshals' certificates, and the original papers required by statute to be recorded to perfect such levies, attachments, notices, lis pendens and certificates on record in the office of the register of deeds, shall be notice to all persons, of the liens, rights and interests acquired by or involved in such proceedings, *and all subsequent owners or incumbrances shall take subject to such liens, rights or interests.* [Emphasis added.][3]

Although our Supreme Court did not characterize vendee's assignment in *Borak* as a mortgage or other lien, the Court nonetheless concluded that subsequent owners or encumbrancers took the property subject to the rights as set forth in the recorded assignment.[4] Therefore, we conclude that, as a matter of law, defendant FRS took its mortgage subject to plaintiff's interest in the property.

Having concluded that defendant FRS' mortgage is subject to plaintiff's interest as vendee's assignee, we must now determine how plaintiff can enforce this interest. Under the facts in this case, we agree with the trial court that plaintiff was entitled to an equitable lien; however, we disagree with the court as to the extent of that lien. An assignment of a land contract as collateral by the vendee may operate to give the assignee an equitable lien on the property. *Levine, supra* at 737. Equity will create a lien against real estate only in those cases where the party has been prevented by fraud, accident or mistake from securing that to which he was equitably entitled. *Cheff v Haan*, 269 Mich 593, 598; 257 NW 894 (1934). This Court defined an "equitable lien" in *Warren Tool Co v Stephenson*, 11 Mich App 274, 281; 161 NW2d 133 (1968):

> "The doctrine [of equitable lien] may be stated in its most general form, that every express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property … therein described or identified, a security for a debt or other obligation, or whereby the party promises to convey or assign or transfer the property as security, creates an equitable lien upon the property so indicated, which is enforceable against the property in the hands not only of the original contractor, but of his heirs, administrators, executors, voluntary assignees, and purchasers or *encumbrancers with notice*. . . ." 4 Pomeroy's Equity Jurisprudence, § 1235, p. 696. [Emphasis added.]

Generally, an equitable lien would be unnecessary to protect the interest of a vendee's assignee, like plaintiff here, because the assignee holds the equitable ownership of the property. See, e.g., *Cheff, supra* at 596, 598, in which the Court determined that the vendee's assignee was not entitled to a mortgage lien, reasoning in part that a lien was not a collateral contract, but a claim against some interest in the property created by law as an incident of the contract. Because plaintiff held a present interest in the property, plaintiff should have been able to obtain its collateral by stepping into Kitsmillers' shoes

and acquiring the legal title to the property under the land contract. However, the Kitsmillers prevented plaintiff from taking this action when they paid off the land contract and executed a mortgage against the property that exceeded the property's purchase price.[5] Furthermore, when the Kitsmillers obtained the deed to the property from the vendor, they held the title to the property in trust for plaintiff, *Levine, supra* at 737, and, as a result, could not mortgage the property in such a manner as to extinguish plaintiff's security interest. See, e.g., *Georges v Ballard*, 20 Mich App 554, 557; 174 NW2d 311 (1969) (where title holder to joint adventure property was constructive trustee of the property, the title holder should not be allowed to mortgage the property for his own private advantage without the consent of the other joint adventurer).

Here, we agree with the trial court that equity should create a lien against the property because plaintiff has been prevented by "fraud, accident or mistake" from securing that to which it was entitled. However, we disagree with the trial court's determination that plaintiff's equitable lien is in the amount of $206,796.86 and that the lien is unenforceable against defendants. When the Kitsmillers assigned their vendee's interest in the land contract, they assigned their "present interest in the lands, together with the right to obtain further interest and final title on the performance of the contract." *Gorman, supra* at 530. We note from the record that the vendor's deed conveying the property to the Kitsmillers contains a stated purchase price of $127,700. We further note that the Kacos assignment stated that it was subject to an outstanding balance on the contract of $112,945.85. Based upon this record, we conclude that the Kitsmillers' present interest in the property at the time of the assignment had a monetary value of $14,054.15. *Id.* Because plaintiff did not make any payments on the contract, and thus obtained no further interest, we do not believe that it should be entitled to any additional equitable interest in the property.

We further conclude that plaintiff's equitable lien is enforceable against defendants because defendants are "encumbrancers with notice." See *Warren Tool, supra* at 281. Defendant FRS had constructive notice of plaintiff's previously recorded interest in the Kitsmillers' contract to purchase the property and took its mortgage subject to that interest. *Boraks, supra* at 311-312; MCL 565.25; MSA 26.543.

Finally, we disagree with defendants' contention that the Kacos assignment was not operative because the Kitsmillers previously assigned that interest to Bender. Smith testified that he and the Kitsmillers intended to release their assignments to Bender and replace them with other security. We find nothing in the record to contradict Smith's testimony that the unrecorded Bender assignment was not collateral for the Bender note. Furthermore, defendants did not object to plaintiff's attorney's representation to the trial court that the Bender loan was not secured and discharged in bankruptcy.

In summary, we affirm the trial court's determination that plaintiff has an equitable lien in the property, but conclude that, as a matter of law the lien is limited to $14,054.15. We also reverse the trial court's judgment that plaintiff had no cause of action against defendants FRS and TMS, and hold that, as a matter of law, defendants' mortgage is subject to this equitable lien. Accordingly, we vacate the trial court's order assessing costs against plaintiff.

Docket No. 214410

Because we have vacated the trial court's order assessing costs against plaintiff, the issues raised in this appeal are moot.

Reversed in part, affirmed in part. No taxable costs pursuant to MCR 7.219, neither party having prevailed in full.

/s/ Gary R. McDonald
/s/ Janet T. Neff
/s/ Michael R. Smolenski

[1] For purposes of our opinion, we will refer to defendants David Kitsmiller and Penny Kitsmiller as the "Kitsmillers."

[2] The trial court made no ruling as to count I. It appears from the record that plaintiff abandoned this count, which sought to collect the $35,000 Bender loan, when it advised the trial court that the loan was not secured and discharged in the Kitsmillers' bankruptcy.

[3] For purposes of this opinion, the relevant portions of CL 1948 § 565.25 and MCL 565.25; MSA 26.543 are identical. We note that MCL 565.25; MSA 26.543 was amended by PA 1996 526, effective March 31, 1997. However, these amendments do not apply here because all of the transactions in this case occurred before the amendatory act's effective date.

[4] Our Supreme Court in *Boraks* did not address whether an assignment of a land contract fell within the definition of a conveyance contained in MCL 565.35; MSA 26.552, which excludes "executory contracts for the sale or purchase of real estate." Likewise, we find it unnecessary to address that issue. Nonetheless, we note that MCL 565.354; MSA 26.674 specifically authorizes the recording of land contracts and declares that such recorded contracts "shall have the same force and effect, as to subsequent encumbrancers and purchasers, as the recording of deeds and mortgages."

[5] We note that the deed from the vendor to the Kitsmillers stated that the price of the property was $127,700. We further note that the Kitsmillers' mortgage to FRS was in the amount of $135,000, some $7,300 more than the stated purchase price.